September 30, 2024

BILBoard October 2024 – Harvest season

EXECUTIVE SUMMARY

As autumn approached, we saw increased volatility on capital markets. Bad days were swiftly followed by significant rallies, and like the leaves currently on the trees, we had a varying mix of red, green, and amber on our screens. For the month of September as a whole, however, the general direction was still positive. In keeping with the season, we decided to harvest some of the gains generated over the course of the year in the equity segment of portfolios.

This decision was based on the fact that we expect volatility to continue in the months ahead. Markets are still trying to ascertain whether the Fed's bumper rate cut will be enough to usher in a soft landing and, as such, emotions may be high when economic data is released, resulting in exaggerated market moves. At the same time, the US Presidential election is heating up. As polls shift, markets could also swing, especially given that the two candidates have very different agendas.

Like shoppers saving up for Black Friday, selling some of our holdings means we have cash at hand to seize opportunities that expected volatility might present in the months ahead – especially in the US equity space.

THE MACRO CONTEXT

"Autumn carries more gold in its pocket than all the other seasons", American author Jim Bishop once wrote. When it comes to the **US economy**, one of the key issues is that consumers don't have many dollars left in their pockets. Excess savings from lockdowns are a distant memory, credit card debt has soared, and delinquency rates are elevated. This is watch-worthy because consumption is the primary growth driver, accounting for around two-thirds of activity. If we don't see any further cooling in the **labour market**, consumers are likely to continue spending on the belief that future income streams aren't under threat. However, if the labour market continues to deteriorate, spending could dry up and the coveted soft landing could run into difficulty. Fully aware of this, the Fed lowered its key rate by 50 basis points to a range of 4.75 to 5% in September. It was the first rate cut in more than four years and signaled a pivot from monetary tightening to a policy of monetary easing. The question now is whether the Fed is too late, or if its actions will bolster the economy and corporate earnings growth. Until there is more certainty on this point, market participants will be particularly sensitive to any signs of economic softness.

The **Presidential election on November 5th** is fast approaching. Patterns of a "Trump trade" and a corresponding "Harris trade" are emerging. The former is campaigning on low taxes, low regulation, low energy costs and higher trade tariffs. Potential beneficiaries are perceived to be big oil, financials, and small caps (which tend to be domestically focused). Input duties as well as a tougher stance on immigration could be inflationary, which in turn could lead to higher long-term yields and a steeper yield curve. Harris has discussed higher corporate taxes, tax credits for lower middle-income families, and a Federal ban on grocery price gouging. Continuity is expected when it comes to the Inflation Reduction Act, launched by Biden. Consumers, renewable energy companies and EV makers are expected to be the key beneficiaries. Health care providers could potentially suffer from Harris' plans to expand Medicare and target drug price reform. At the time of writing, Harris was slightly ahead of Trump in the polls (48.4% to 45.8%[1]) though the situation continues to evolve, and no definite conclusions can be drawn.

In many parts of the **Eurozone**, including Luxembourg, it's hard to believe that Autumn has already arrived, given that we were somewhat cheated out of a summer this year. There are parallels to be drawn with the economy. While all signs pointed to an economic upturn at the start of the year, the sun failed to shine on the bloc and the economy remains stuck in the mud with little sign of improvement. While service-oriented Southern economies have held up relatively well, **malaise in the manufacturing sector** is weighing heavily on the European economy, with Germany re-entering contraction territory in Q2. An anticipated upturn in **consumption** has been slow to materialise, despite rising real incomes in key economies. The ECB has indicated a gradual rate cut campaign given the embedded stickiness in inflation prints. This is largely due to the service sector, where uncomfortably high wage growth is pushing up costs. Unemployment remains at a record low of 6.4%.

Looking to **China**, the macroeconomic situation continues to be challenging. Consumption remains very weak, leading the country almost to the brink of deflation. The PBoC has unveiled a broad package of monetary stimulus measures in an attempt to revive activity, including rate cuts, reduced reserve requirements and additional support to the property sector. Direct measures aimed at boosting consumption are perceived as the "missing ingredient" by some analysts.

INVESTMENT DECISIONS

As part of our most recent asset allocation, **we trimmed exposure to both US and European equities**. Globally, this leaves us slightly underweight equities, with a modest overweight to the US. We are slightly positive on Emerging Markets ex-China, and underweight on Europe, Japan, and China.

The proceeds from the sale of those equities are being held in cash but we aren't squireling it away and entering hibernation. We are actively seeking opportunities to exploit volatility that may arise, in order to identify opportune entry points – especially in US equities where earnings growth is holding up and where the expectations hurdle for future results has been lowered.

In terms of currencies, we **lowered US dollar exposure** within portfolios (the proceeds of the aforementioned trades are held in euros and we also applied currency hedging to 2 percentage points of our US equity exposure in each risk profile). The greenback recently touched a 14-month low against a basket of currencies and further weakening is possible: though the Fed is unlikely to sustain a pace of half-point cuts, it is still looking to ease policy faster than the ECB, which would weigh on the USD, all else equal…

Looking at sectors, we **upgraded US Consumer Discretionary from negative to neutral**. While questions remain about the long-term stamina of US consumers, in the near term they have shown resilience in against high rates and elevated prices, with spending rising at a generous 2.9% in Q2. Spending could be supported in the near-term by the fact that mortgage rates are now falling. Consumers will also feel the benefit of lower oil prices, given the US' firmly ingrained driving culture. Gas prices have plunged as demand dropped at the end of the busy summer travel season and despite ongoing geopolitical risks. In some states and at some gas stations, prices have fallen below 3 USD a gallon, the lowest level in more than three years.

To recap our other sectoral preferences, we continue to favour **IT** (market positioning is now less crowded), **Utilities**, **Real Estate**, **US Communication Services** and **European Pharma**.

In the **Fixed Income** realm, we favour quality investment grade, which remains in a sweet spot with an economy that is neither too hot nor too cold. We continue to have only **light exposure to Sovereigns**, as we feel rate markets are vulnerable to a pull-back as market participants remain far more dovish than the Fed in their expectations for rates this year and next. Uncertainties regarding budget deficits in the US and Europe might also re-appear in the coming months, with neither US Presidential candidate having done much to alleviate concerns and the French government yet to approve its budget. In terms of **duration**, we're focusing on the intermediate part of the curve, seeking insulation from potential volatility on both the short-end (everchanging expectations about monetary policy), and the long-end (shifting views about debt, growth and inflation).

Whether the markets are experiencing autumn, winter, summer, or spring-like conditions, our aim is to capture performance for our clients with a four-seasons approach. More specifically, this means being invested across the course of the cycle, and adjusting where required in order to take advantage of short-term opportunities.

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[1] According to fivethirtyeight as of 26/9/24

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